NATIONAL JUVENILE JUSTICE NETWORK

Social Impact Bonds
TIP SHEET

APRIL 2014

What Is a Social Impact Bond?

The goal of a Social Impact Bond (SIB) is to improve social outcomes while effectively allocating scarce public-sector resources. SIBs are a public-private partnership in which private investors adopt the risk that a social program may not produce its desired outcomes. Government officials decide what problems they want to address and which programs would solve those problems. An intermediary works with the officials to identify the anticipated outcomes for that program and locates independent investors such as banks, foundations and individuals that provide the capital for the program. The investors pay the upfront costs for the program or interventions to the intermediary, and the government releases payment to the intermediary once the outcomes have been achieved, as determined by an independent evaluator. The intermediary reimburses the investor for its initial capital outlay, a modest interest on the principal, and a portion of the government savings, if warranted.[1] Thus, SIBs can provide governments with funds for social programs during times of fiscal scarcity through an arrangement that may protect taxpayers because payment is only required when the program is successful.

ABOUT "PAY FOR SUCCESS"

Pay for Success (PFS) is a term that is sometimes used interchangeably with SIBs, but represents a larger category of performance-based contracts. PFS refers to a contract between government and another entity in which pay is linked to the fulfillment of basic contractual obligations. For example, the government may promise to pay a service provider if it meets its target for number of youth served. The government may include in the contract extra payments or bonuses for performance, such as on-time completion. A SIB, by contrast, reimburses an investor for its principal, interest and a share in the savings, but only if the program produced outcomes that generated government savings. So even though many of the new SIB projects are being labeled as "PFS," they incorporate this additional factor of paying investors for a portion of the government savings.

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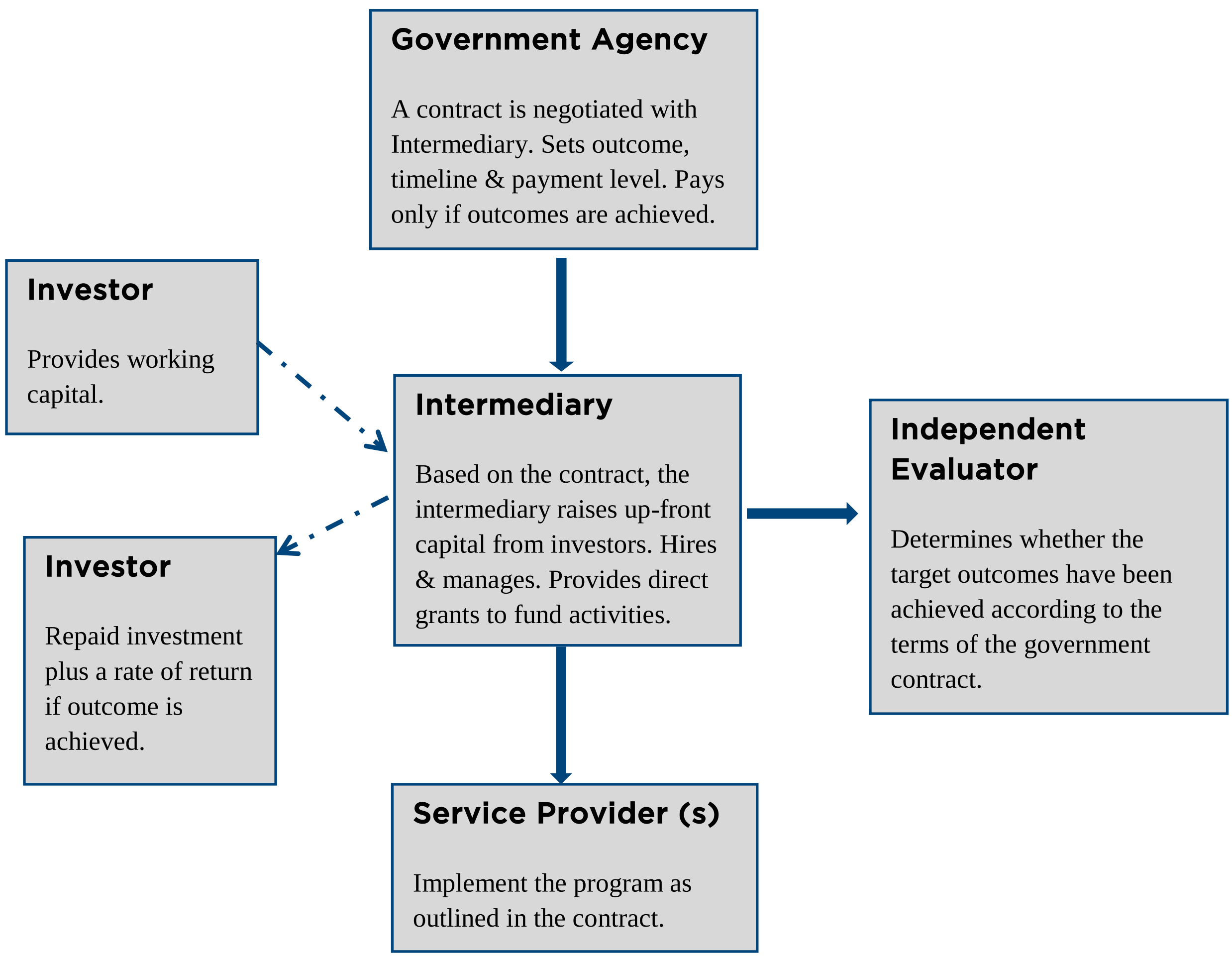
History of Social Impact Bonds

Social impact bonds (SIBs) have only recently been introduced in the United States, but have quickly gained popularity. SIBs were introduced in the United Kingdom around the fall of 2010. In February 2011, President Barack Obama's proposed 2012 budget stated that up to $100 million would be freed up to run social impact bond pilot schemes.[2] In early 2012, state and local governments across the United States began launching social impact bond pilots.[3] Currently there isn't any information or data available on the success of projects initiated over the past few years. However, the Center for American Progress predicts that the existing SIB pilot initiatives will be models for other jurisdictions across the country as they explore using social impact bonds in a wider range of policy areas.[4]

Who Are the Key Players?



How Is a SIB Constructed?[5]

- If there is sound statistical research that shows the future economic benefit of a program, a SIB may be a good option for initiating a program with private funds.
- A government agency or agencies will typically be the initiating party in a SIB contract. The agency will have primary responsibility for defining the outcomes, population, and will make the payment if the outcome is achieved.
- The government then contracts with an intermediary and promises to pay the intermediary a pre-arranged sum if and only if the outcomes are met. The intermediary is in charge of achieving that outcome itself or must contract with an organization to achieve that outcome. Thus, the intermediary is in charge of:
  - finding the investors to fund the project;
  - running the project itself or hiring service providers to run the project;
  - potentially engaging an evaluation advisor to assist in data collection; and
  - retaining an evaluator to analyze data and assess whether the outcomes were achieved.
- Investors provide working capital to pay for the interventions. If the SIB is successful, the investors are repaid with a rate of return negotiated up front with the government and the intermediary.
- The intermediary hires service providers with proven track records of success. The service providers' pay is not entirely contingent on the outcome being achieved—they instead receive direct, sometimes multi-year grants from the intermediary, which uses the capital fronted by the investors.
- A third-party evaluator verifies the achievement of the outcome using a methodology agreed upon by the government and the intermediary at the outset of a social impact bond agreement.
- If the program achieves the agreed-upon outcome, the government releases funds to the intermediary, which then repays investors with a rate of return negotiated upfront between the intermediary and the investors. If the program fails to meet the targeted outcomes, the state agency is not obligated to repay the intermediary; the investors do not get repaid or a return.

What Are the Potential Benefits of SIBs?

- The risk is transferred away from the government and taxpayers. Government agencies aren't on the hook for payment if the service providers fail to achieve the stated outcomes.
- Private investors put up the capital to fund programs that could be too risky for the public sector.

- SIBs could potentially shift the way government funds social services by requiring more robust data collection, clear performance metrics, and detailed measurement of social outcomes. SIBs can provide a boost to juvenile justice realignment initiatives by providing seed funding for new community-based alternatives to incarceration and detention.

What Are the Potential Pitfalls of SIBs?

- Not every type of program or intervention is right for a SIB. Since SIBs rely in part on future government cost savings to repay investors, only SIB projects that have sound research-based evidence for outcomes that produce savings—such as lowered recidivism or improved health care—will work in the SIB context.
- SIBs can be more expensive than just paying directly for services because they require intermediaries to secure the up-front investment and to evaluate the program outcomes. SIBs also require the government to pay a return on the initial investment; essentially the fee for the outside investor assuming the risk.
- SIBs can be very complex due to the difficulty of measuring outcomes.
- Returns on SIBs are not realized until after the independent evaluator verifies the outcomes have been met, which can present problems for bondholders who seek a quick return on their investment.
- If the social impact bond identifies unrealistic expectations for program outcomes, it could lead to an unnecessarily negative assessment of a good program that might prevent the program from being implemented in the future.
- It could be argued that it is problematic for investors to make a profit off the savings garnered from the creation of effective community programs with proven outcomes. Ideally at least a portion of these savings would be retained by the government and utilized for increased services rather than into the hands of investors.
- Some argue that SIBs essentially privatize the financing of services that should be the responsibility of government. Concomitantly, involving private investors in social programs may lead to a shifting of priorities, where the bottom line and the focus on a selection of outcomes become more important than the larger mission.

Examples of Current Social Impact Bond Initiatives

- ***Massachusetts Juvenile Justice Initiative***
  Serves young men and boys in the probation system or who are exiting the juvenile justice system through intensive street outreach and targeted life skills, education, and employment programming. Outcomes are tied to recidivism and increased employment.[6]
- ***Riker's Island Correctional Facility in New York City***

Incarcerated adolescents receive targeted education, counseling and training. Outcomes are tied to reduced recidivism rates.[7]

- ***Utah High Quality Preschool Program***
  Expands access to early childhood education for at-risk children in Utah. Outcomes are tied to preparing children for kindergarten, closing the achievement gap, keeping young people on track to complete high school, and decreasing the use of special education and remedial services in elementary school.[8]

Conclusion

In the juvenile justice context, social impact bonds can offer an innovative way for government to shift resources from costly facilities to more effective community-based programs. All investments come with risks; one of the benefits of social impact bonds to government is that there is a degree of risk transference—if the program does not perform, the government is not on the hook financially.

However, the verdict is still out on SIBs; since they are a relatively new financing vehicle for social programs, there is no currently available data about their effectiveness. State advocates should keep a close watch on the development of SIBs in their home state and seriously consider them as a financing vehicle for justice-related initiatives.

[1] Kristina Costa, et al., "Frequently Asked Questions: Social Impact Bonds" (Washington, D.C.: Center for American Progress, December 5, 2012), accessed April 16, 2014, http://bit.ly/1scsIM6.
[2] "Who Succeeds Gets Paid" *The Economist,* Feb 17, 2011, accessed March 21, 2014, http://econ.st/PmXenx.
[3] David Chen, "Goldman to Invest in City Jail Program, Profiting if Recidivism Falls Sharply." *The New York Times*, August 2, 2012, accessed March 21, 2014, http://nyti.ms/1mDxn5S.
[4] Kristina Costa, "Social Impact Bonds: New York City and Massachusetts to Launch the First Social Impact Bond Programs in the United States" (Washington, D.C., Center for American Progress, November 5, 1012), accessed March 21, 2014, http://bit.ly/Of6VDb.
[5] Costa, et al., "Frequently Asked Questions," http://bit.ly/1scsIM6.
[6] Third Sector Capital Partners, "Fact Sheet: The Massachusetts Juvenile Justice Pay for Success Initiative," accessed March 21, 2014, http://bit.ly/1lDSPdx.
[7] John Olson and Andrea Phillips. "Rikers Island: The First Social Impact Bond in the United States" (Federal Reserve Bank San Francisco, 2013): 97-101, accessed March 21, 2014, http://bit.ly/Of9gOL.
[8] Goldman Sachs, "Fact Sheet: The Utah High Quality Preschool Program" (2012), accessed March 21, 2014, http://bit.ly/Of9BRq.